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Person To Contact:

Telephone Number:

Refer Reply To:

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Date:

April 30, 2015

### Legend:

City =

Smart Card =

Transit Authority =

X =

Y =

Dear :

This is in reply to your September 16, 2014 letter and subsequent correspondence requesting a private letter ruling concerning the federal income and employment tax consequences of Smart Cards given by City to its employees.

### Facts:

In order to meet social, economic and environmental sustainability goals, City has approved the allocation of funds to purchase Smart Cards for its employees as well as other eligible employees who work in a designated area. City has entered into a contract with Transit Authority to provide Smart Cards. Transit Authority is a regional authority operating public transit services.

Pursuant to the contract with Transit Authority, City purchases a discounted annual Smart Card for each of its full-time and part-time employees. The Smart Card entitles the card holder to ride on all parts of Transit Authority's regular bus route transportation system as well as certain rapid transit systems operated by Transit

Authority. The Smart Card can only be used for transit on Transit Authority's mass transit facilities.

The cost of the Smart Card to City is computed based on the total number of employees multiplied by the cost of the Smart Card for the "area" in which they work, as determined by Transit Authority. The Smart Card for employees in Area A costs City X per year. The Smart Card for employees in Area B costs City Y per year. While the cost of the Smart Card varies based on the location of the employee, the Smart Cards are identical in functionality for both Area A and Area B.

Pursuant to the contract, City must purchase a Smart Card for each employee. At the beginning of each calendar year, City makes the Smart Card available to all City employees. The Smart Card expires the following December 31.

The Smart Card includes a photo of the employee and cannot be resold or transferred to another individual. Pursuant to the contract, City deactivates the Smart Card for any employee who ceases to be eligible for the Smart Card (e.g., the employee retires or otherwise discontinues employment).

City has entered into a similar contract with Transit Authority to provide the Smart Card to all full-time employees who work in a designated area of the City for employers other than City. No rulings were requested on the tax consequences of that program nor are any rulings given.

### Law

Section 61(a)(1) of the Internal Revenue Code provides, in part, that gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 1.61-21(a)(2) of the Income Tax Regulations provides that to the extent that a particular fringe benefit is specifically excluded from gross income pursuant to another section of subtitle A of the Code, that section shall govern the treatment of that fringe benefit.

Section 1.61-21(a)(3) provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Section 1.61-21(b)(2) provides that the fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. The regulation further provides that an employee's subjective perception of the value of a fringe benefit is not relevant to the determination of a fringe

benefit's fair market value nor is the cost incurred by the employer determinative of its fair market value.

Section 132(a)(5) provides that any fringe benefit that is a qualified transportation fringe is excluded from gross income.

Section 132(f)(1) provides that the term "qualified transportation fringe" includes any transit pass.

Sections 132(f)(5)(A) and 1.132-9(b), Q/A-3 provide that a transit pass is any pass, token, farecard, voucher or similar item entitling a person to transportation (or transportation at a reduced price) if such transportation is on mass transit facilities or is provided by any person in the business of transporting persons for compensation or hire in a commuter highway vehicle.

Section 1.132-9(b) Q/A-18 provides that there are no employee substantiation requirements if an employer distributes a transit pass (including a voucher or similar item) in-kind to the employer's employees.

Section 1.132-9(b), Q/A-5 provides that an employer may provide qualified transportation fringe benefits only to individuals who are currently employees of the employer at the time the qualified transportation fringe is provided.

Section 132(f)(2) provides a monthly limit on the amount of the fringe benefit provided by the employer which may be excluded from an employee's gross income under §132(a)(5).

Section 132(f)(6) provides for an annual cost-of-living adjustment in the monthly limit. The amount of the fringe benefit which may be excluded from an employee's gross income and wages for 2015 is limited to \$130 per month for the aggregate of transportation in a commuter highway vehicle and transit passes.

Section 1.132-9(b), Q/A-8 provides that an employee must include in gross income the amount by which the fair market value of the benefit exceeds the sum of the amount, if any, paid by the employee and the amount excluded from gross income under section 132(a)(5).

Section 1.132-9(b), Q/A-9(b) provides that transit passes distributed in advance for more than one month, but not for more than twelve months, are qualified transportation fringe benefits if the requirements of Q/A-9(c) are met. The applicable statutory monthly limit under section 132(f)(2) may be calculated by taking into account the monthly limits for all months for which the transit passes are distributed. In the case of a pass that is valid for more than one month, such as an annual pass, the value of

the pass may be divided by the number of months for which it is valid for purposes of determining whether the value of the pass exceeds the statutory monthly limit.

Section 1.132-9(b), Q/A-9(c)(1) provides that the value of transit passes provided in advance to an employee with respect to a month in which the individual is not an employee is included in the employee's wages for income tax purposes.

Section 1.132-9(b), Q/A-9(c)(2) provides that if transit passes are distributed in advance for more than three months, the value of transit passes provided for the months during which the employee is not employed by the employer is includible in the employee's wages for employment tax purposes regardless of whether at the time the transit passes were distributed there was an established date of termination of the employee's employment.

Section 1.132-9(b), Q/A-9(d) provides examples. In Example 5, Employer F has a qualified transportation fringe benefit plan under which its employees receive transit passes semi-annually in advance of the months for which the transit passes are provided. All employees of Employer F, including Employee X, receive transit passes from F with a value of \$390 on June 30 for the 6 months of July through December (of a year in which the statutory monthly transit pass limit is \$65). Employee X's employment terminates and his last day of work is August 1. Employer F's other employees remain employed throughout the remainder of the year.

In this Example 5, the value of the transit passes provided to Employee X for the months September, October, November, and December (\$65 times 4 months equals \$260) of the year is included in X's wages for income and employment tax purposes. The value of the transit passes provided to Employer F's other employees is excludable from the employees' wages for income and employment tax purposes because such value does not exceed the statutory monthly transit pass limit (\$65 times six months equals \$390).

Section 3402(a) provides that every employer making a payment of wages shall deduct and withhold upon such wages an income tax determined in accordance with tables or computational procedures prescribed by the Secretary. Section 3102(a) provides a similar withholding obligation on employers with respect to employee Federal Insurance Contributions Act (FICA) taxes imposed by section 3101. Section 3111 imposes a corresponding tax on the employer.

Section 3401(a) provides, for federal income tax withholding purposes that wages mean all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Section 3401(a)(19) excepts from wages any benefit provided to or on behalf of an employee if, at the time such benefit is provided, it is reasonable to believe

that the employee will be able to exclude it from income under section 132. Section 3121(a)(20) provides a parallel exclusion from wages for FICA tax purposes.

Section 1.132-9(b), Q/A-22(a) provides that qualified transportation fringe benefits not exceeding the applicable statutory monthly limit are not wages for purposes of FICA and federal income tax withholding. Qualified transportation fringe benefits exceeding the applicable statutory monthly limit are wages for purposes of FICA and federal income tax withholding and are reported on the employee's Form W-2, Wage and Tax Statement.

Section 1.132-9(b), Q/A-22(c) provides that if the value of noncash qualified transportation fringes exceeds the applicable statutory monthly limit, the employer may elect, for purposes of FICA and federal income tax withholding, to treat the noncash taxable fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually.

Based solely on the information submitted, we rule as follows:

1) Because the Smart Card is a transit pass under section 132(f)(5)(A), the employee may exclude the monthly fair market value of the Smart Card, up to the applicable statutory monthly limit, from income. If the monthly fair market value of the Smart Card exceeds the statutory limit, the excess amount is included in the employee's gross income and wages.

2) For purposes of determining whether the value of the Smart Card exceeds the statutory monthly limit, one twelfth of the fair market value of the annual Smart Card is attributable to each month for which it is valid.

3) Provided the Smart Card is deactivated for any employee who ceases to be eligible for the Smart Card, the value of the Smart Card will not be included in the employee's gross income or wages for the months during which the Smart Card is deactivated.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lynne Camillo  
Branch Chief, Employment Tax Branch 2 (Exempt  
Organizations/Employment Tax/Government  
Entities)  
(TEGE Associate Chief Counsel)

Enclosures:

Copy of letter  
Copy for section 6110 purposes